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CASE COMMENT

Lorna Richardson*

Commercial Common Sense Revisited: Further Developments in Contract Interpretation and Commercial Leasing

In *@SIPP (Pension Trustees) Ltd v Insight Travel Services Ltd*¹ the Inner House interpreted a commercial lease and considered, in particular, the use of commercial common sense in the interpretive exercise. In doing so the Court was clearly influenced by the Supreme Court decision in *Arnold v Britton*.² The Inner House took a very different approach to the use, and meaning, of commercial common sense to that taken in the earlier Inner House decision of *Grove Investments Ltd v Cape Building Products Ltd*³ despite the similar factual circumstances.

While the Inner House's comments on commercial common sense will likely be the focus of discussion of *@SIPP*, the case also heralded a significant development regarding the extent of a tenants' repairing obligation, holding that an obligation to keep leased subjects in good and substantial repair carried an obligation to *put them into* and thereafter keep them in that state of repair. This is contrary to what was previously understood to be the position and brings Scots law into line with English law on this point. The Court's decision may result in tenants being under significantly greater obligations than were anticipated when they entered into commercial leases.

A THE FACTS

The reclaimers were landlords of commercial property, which had been let to the respondent tenants. The lease had ended. The landlords claimed that at lease termination the subjects were not in good and substantial repair, as required by the lease. According to the landlords the total estimated cost of works to put the premises into the required condition was £1,051,086.25. The tenants averred that if they had carried out the works they accepted should have been carried out before lease end the capital value of the subjects would have been increased by £75,000. Even if they carried out all of the works the landlords claimed should be carried out the capital value would be increased by £175,000. The tenants claimed that no reasonable landlord would carry out the works and, in fact, believed that the landlords did not intend to do the works. As such, argued the tenants, the landlords' claim should be quantified by reference to diminution in capital value of the subjects rather than the cost of the works.

The Inner House had to consider two issues. Firstly, whether the tenants' obligation at termination was limited to putting the premises into the condition

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¹ [2015] CSIH 91; 2016 SLT 131.

² [2015] 2 WLR 1593.

³ [2014] CSIH 43. See the analysis in L Macgregor, "Crossing the line between business common sense and perceived fairness in contractual interpretation" 2015 19(3) ELR 378.

in which they were accepted by the tenants at lease commencement. Secondly, whether the landlords were entitled to payment of a sum equal to the cost of putting the premises into the required state of repair, regardless of whether the landlords actually intended to carry out the works.

In terms of the lease the tenants were obliged:

(Three) To accept the lease subjects in their present condition and at their own cost and expense to repair and keep in good and substantial repair and maintained, paved... in every respect all to the satisfaction of the Landlord and to replace or renew or rebuild whenever necessary the leased subjects and all additions thereto and all drains, soil and other pipes,... and parts, pertinents and others therein and thereon in at least as good condition as they are accepted by the Tenant all to the satisfaction of the Landlord and that regardless of the age or state of dilapidation of the buildings or others for the time being comprised in the leased subjects.....⁴ and

(Seven) At the expiry or sooner termination of the...Lease.to surrender to the Landlord the leased subjects... in such state and condition as shall in all respects be consistent with a full and due performance by the Tenant of the obligations herein contained... Provided always that if the Landlord shall so desire at the expiry or sooner termination of the ...Lease they may call upon the Tenant, by notice in writing (in which event the Tenant shall be bound), to pay to the Landlord at the determination date... a sum equal to the amount required to put the leased subjects into good and substantial repair and in good decorative condition in accordance with the obligations and conditions on the part of the Tenant herein contained in lieu of requiring the Tenant himself to carry out the work.⁵

B THE EXTENT OF THE TENANTS' REPAIRING OBLIGATION

The Lord Ordinary had held that the words "in at least as good condition as they are accepted by the Tenant" were key and applied to all aspects of the tenants' obligations therefore excluding any obligation to leave the subjects in any state of improvement.⁶

Lady Smith gave the judgement of the Inner House. She noted that in interpreting the lease the ultimate aim was to determine what the parties meant by the language used. This was done by ascertaining what a reasonable person with all the background knowledge available to the parties would have

⁴ Para [2].

⁵ Para [2].

⁶ Para [7].

understood the parties to have meant.⁷ Lady Smith noted that the task had been “distilled” by Lord Neuberger⁸ in *Arnold v Britton*⁹ who had stated,

The meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provision of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party’s intention.¹⁰

Lady Smith went on to note the emphasis placed by Lord Neuberger on the fact that “commercial common sense should not be invoked to undervalue the importance of the language used by the parties in the contractual provision being construed”.¹¹ While Lord Neuberger had stated that “poor drafting makes it easier to depart from the natural meaning and clear drafting makes it more difficult to do so, the court is not thereby justified in embarking on an exercise of searching for or constructing drafting infelicities so as to facilitate such departure”.¹² Lady Smith, again drawing on Lord Neuberger’s comments in *Arnold v Britton*, noted that,

commercial common sense is only relevant to how matters would have been perceived at the time of contracting and is not to be invoked retrospectively; and that although commercial common sense is very important the court should be slow to reject the natural meaning of a provision as correct simply because it seems to be a very imprudent term for one of the parties to have agreed, the purpose of interpretation being not to identify what the court thinks that parties ought to have agreed but what they have in fact agreed.¹³

The Court considered the fact that the parties had not appended a schedule of condition¹⁴ to the lease as weighing significantly against a construction which limited the tenants’ obligations.¹⁵ The Inner House found that it was clear that the natural meaning of the words demonstrated the parties’ intention that the overriding, and minimum, repairing standard was “good and substantial repair”.¹⁶ If the condition of the premises at lease commencement was below that standard the tenants had to perform their obligation “to repair and keep in

⁷ Para [17], citing *Rainy Sky v Kookmin Bank* [2011] 1 WLR 2900.

⁸ Para [17]

⁹ [2015] 2 WLR 1593.

¹⁰ *Ibid* at para [15].

¹¹ [2015] CSIH 91; 2016 SLT 131 at para [17]

¹² *Ibid*

¹³ *Ibid*.

¹⁴ A record (often including photographs) of the condition of the subjects at lease commencement.

¹⁵ Para [19]. This was also an issue which weighed against the tenants in *Taylor Woodrow Properties Ltd v Strathclyde Regional Council* 15 Dec 1995, unreported, although it did not prevent the Court from finding in the tenants’ favour in *McCall’s Entertainment (Ayr) Ltd v South Lanarkshire Council (No 2)* 1998 SLT 1421.

¹⁶ Para [20].

good and substantial repair”, in a way that achieved that standard.¹⁷ The obligation “to repair” was indicative of that, but if there was any doubt about that the balance of authority¹⁸ supported the conclusion that an obligation to keep subjects in good and substantial repair carried an obligation to put them into that state of repair.¹⁹ The position might have been different if there had been no obligation to renew, reinstate and rebuild as necessary.²⁰ The phrase “regardless of the age or state of dilapidation of the buildings” confirmed that the tenants were not to be excused of their obligation to repair, maintain and renew to at least “good and substantial repair” by reason of them being below that standard at commencement.²¹

C THE LANDLORDS’ CLAIM FOR COST OF WORKS

Lady Smith noted that the Lord Ordinary had approached his consideration of this issue with the observations in *Grove Investments Ltd v Cape Building Products Ltd*²² in mind. The Lord Ordinary had found that “a sum equal to the amount required to put the leased subjects into good and substantial repair” was amenable to two possible constructions and that the words “in lieu of requiring the Tenant to carry out the work” afforded a clear indication that the payment obligation was activated only if the landlords intended to carry out the works.²³

Lady Smith reiterated that the Court’s task was to determine what the parties meant by the language used by ascertaining what a reasonable person with all the background knowledge available to the parties would have understood the parties to have meant, looking for the natural and ordinary meaning.²⁴ The Inner House was satisfied that the only natural and ordinary meaning was that the clause was a payment clause; the sum due was the cost of repair; and questions of whether and to what extent the premises were worth less in capital terms was irrelevant.²⁵ To find that the lease simply provided the landlords with a claim for damages, as contended by the tenants, flew in the face of common sense so as to exclude it from the possibility of being an alternative construction.²⁶

¹⁷ *Ibid.*

¹⁸ *Credit Suisse v Beegas Nominees Ltd* [1994] 4 All ER 803 as followed in *Taylor Woodrow Properties Ltd v Strathclyde Regional Council* 15 Dec 1995, unreported; *Lowe v Quayle Munro* 1997 SC 346; and *L Batley Products Ltd v North Lanarkshire Council* [2014] UKSC 27.

¹⁹ Para [20].

²⁰ As was the case in *McCall’s Entertainment (Ayr) Ltd v South Lanarkshire Council (No 2)* 1998 SLT 1421.

²¹ Para [21]. Although this phrase is used in commercial leases to pass to tenants obligations for extraordinary as well as ordinary repairs – see *Lowe v Quayle Munro Ltd* 1997 SC 346 at 350-351.

²² [2014] CSIH 43.

²³ Para [26].

²⁴ Para [36].

²⁵ Para [37].

²⁶ Para [37], citing *Rainy Sky v Kookmin Bank* [2011] 1 WLR 2900 and *Barclays Bank plc v HHY Luxembourg SARL* [2011] 1 BCLC 336.

The Court considered that the case could readily be distinguished from *Grove* given the different terms of the relevant payment obligations.²⁷ Lady Smith noted that the Lord Ordinary had read some of the observations in *Grove* as being standalone statements of principle, namely that a contract was a co-operative enterprise; that a contract should normally be construed in such a way as to avoid arbitrary or unpredictable burdens; that the common law often serves as a benchmark against which considerations of fairness could be measured; and that a radical departure from the common law could indicate that a construction was commercially unreasonable.²⁸ Lady Smith noted a number of reservations. First of all, the general observations in *Grove* ought not to be taken as indicating that the considerations of co-operation and mutuality that would be appropriate to partnerships or joint ventures applied across the board. She continued,

Commercial contracts may, equally, be hard fought with each party intent on securing their own particular objective.... Care must be taken to avoid reading anything said in *Grove* as being to the effect that the court can correct a bad bargain or even an unfair one; there is no general rule that a commercial contract requires to be fair... It is not legitimate to re-write parties' agreement.²⁹

Lady Smith also noted,

the observations in *Grove* predated the guidance provided by the Supreme Court in *Arnold* and must, accordingly, be regarded with an appropriate degree of caution. Finally, it is important to note that *Grove* did not lay down any general rule to the effect that the landlord in a commercial lease is, at termination, if repairs are outstanding only entitled to be compensated for capital loss actually suffered. Whilst the court concluded, in *Grove*, that that was the outcome that accorded with commercial commonsense, the context was its interpretation of the relevant clause in that lease...³⁰

D CONCLUSIONS

The Extra Division in this case was at pains to distance itself from the decision of a differently constituted Extra Division in *Grove*. Following *@SIPP*, it is clear that *Grove* does not set down general rules regarding the interpretation of commercial contracts,³¹ or indeed commercial leases, but deals solely with the clause in question. *@SIPP*, following the Supreme Court decision in *Arnold v Britton*, brings the law of interpretation in Scotland and England into line. In both cases the Court, while noting that commercial common sense was important,

²⁷ Para [42].

²⁸ Para [43].

²⁹ Para [44].

³⁰ Para [44].

³¹ As had been thought to be the case following *Grove* – see *Mapeley Acquisitions Co (3) Ltd v City of Edinburgh Council* [2015] CSOH 29; 2015 GWD 13-234 at para [13] and *Richard Bishop v 3i Investments plc* [2014] CSOH 152; 2014 GWD 33-634.

sought to set limits on when it could legitimately be used in the interpretive exercise.

The Inner House called into question the statements made by the Court in *Grove* that contracts are co-operative enterprises, entered into by parties for their mutual benefit. Lady Smith acknowledged that a commercial contract is something which may be hard fought with both parties seeking to secure their own objectives. This, it is suggested, is closer to the position with most commercial contracts, including commercial leases. Each party is likely to seek to agree terms most beneficial to his own interests, without much, if any, consideration for the interests of his contractual partner. There is, as Lady Smith notes, no general rule that commercial contracts must be fair. The decision, in relation to this issue is welcome.

The Court's decision on the extent of the tenants' repairing obligation is more doubtful. It is arguable that the clause containing the repairing obligation had more than one interpretation and that the interpretation favoured by the Lord Ordinary was the most commercially sensible. While the Inner House's decision appears to have been made on the use of "to repair" in the relevant clause the Court went on to hold that an obligation to "keep subjects in good and substantial repair" carries an obligation to put them into that state of repair. It is suggested that this is incorrect. In English law an obligation to keep subjects in repair includes an obligation to put the subjects into that state and thereafter keep them in that condition.³² This was not thought to be the position in Scots law. In *Napier v Ferrier* Lord Fullerton stated,

...it appears to me that an obligation to keep the premises in repair during the existence of a lease necessarily implies, not an obligation on the tenant to put them into repair, but the understanding of the parties that they were to be in repair when the lease commenced. That is an implication in perfect accordance with the usual common-law obligations of a landlord; whereas the other construction, viz . that the tenant is to put the premises into repair, is contrary to the usual understanding, and would require the clearest expression of intention to support it.³³

Napier v Ferrier does not appear to have been referred to in either the parties' submissions or the decision of the Court.³⁴

The Scottish cases cited by Lady Smith on this issue did not determine that an obligation to keep premises in a certain state of repair includes an obligation to put them into that condition.³⁵ The rationale used by the Inner House in *@SIPP*

³² See eg *Proudfoot v Hart* (1890) QBD 42.

³³ (1847) 9 D. 1354 at 1360.

³⁴ There is no reference to it in the official transcript of the case or the reports of the case. *Napier* was referred to in the landlords' submissions in the Outer House see [2014] CSOH 137; 2014 Hous LR 54 at para [8].

³⁵ In *Lowe v Quayle Munro* 1997 SC 346 Lord Penrose determined *inter alia* the extent of the tenants' repairing obligation by applying the disregard "regardless of the age or state of dilapidation of the buildings" to each of the tenants' obligations in the repairing clause. In *Taylor Woodrow Properties Ltd v Strathclyde Regional Council*, 15 Dec 1995, unreported

on this issue is unpersuasive. It is suggested that the Lord Ordinary's analysis of this aspect of the case is preferable.³⁶

The effect of *@SIPP* is that tenants with an obligation to keep leased premises in good condition, when they are accepted in their present condition at commencement, will have to carry out improvements to the premises to bring them up to good condition and thereafter maintain them to that standard. This is likely to be a more onerous obligation than tenants anticipated given what was considered the established legal position prior to this decision.

Lord Penrose was content to follow the English case of *Credit Suisse v Beegas Nominees Ltd* [1994] 4 All ER 803 in deciding that a tenants' repairing obligation could be triggered despite there being no disrepair but that was as far as he went; there was no discussion of the difference between Scots and English law on the obligation to keep premises in repair; *Napier v Ferrier* was not mentioned. In *L Batley Products Ltd v North Lanarkshire Council* [2014] UKSC 27 the Supreme Court had to consider whether notice of wants of repair was needed to trigger the tenants' repairing obligation.

³⁶ See *@SIPP (Pension Trustees) Ltd v Insight Travel Services Ltd* [2014] CSOH 137; 2014 Hous LR 54 at paras [11]-[17].